Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap	)	WC Docket No. 05-25
Local Exchange Carriers	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform	)	
Regulation of Incumbent Local Exchange Carrier	)	RM-10593
Rates for Interstate Special Access Services	)	

REPLY COMMENTS
OF
360 NETWORKS (USA), INC.
ATX COMMUNICATIONS, INC.
BRIDGECOM INTERNATIONAL, INC.
BROADVIEW NETWORKS, INC.
CAVALIER TELEPHONE, LLC
DELTACOM, INC.
INTEGRA TELECOM, INC.
LIGHTYEAR NETWORK SOLUTIONS, LLC.
MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.
PENN TELECOM, INC.
RCN TELECOM SERVICES, INC.
SAVVIS, INC.
U.S. TELEPACIFIC CORP. D/B/A TELEPACIFIC COMMUNICATIONS

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SUMMARY

As predicted, the BOCs proclaim that the Commission's special access pricing rules, which includes price cap, pricing flexibility, and CALLS policies, have been enormously successful. While this may be so for the BOCs who are the direct and obvious beneficiaries of this deregulatory regime, they have been a complete and unabashed failure for special access purchasers and the telecommunications market as a whole. Although the Commission had the best intentions (based on its predictive judgment) when it chose a more hands-off deregulatory approach to special access pricing, the Commission policy backfired and ratepayers have been exploited as a result. In absolute dollars, BOCs have overcharged 8.31 billion last year in excessive special access revenues or 22.77 million in overcharges per day in 2006.

This is only a fraction of the overall harm this failed regulatory regime has caused for jobs and the US economy as a whole. In fact, for the years 2007 to 2009, an analysis submitted by ETI on August 8, 2007 shows that the BOCs' special access pricing will cost the United States economy 234,000 jobs and roughly $66 billion in economic output if the Commission does not reform its special access pricing rules. Given this, the Commission must act promptly because the United States is overwhelmingly reliant on the BOCs' special access facilities. Indeed, without access to these facilities and as the ETI analysis shows, there would be limited wireless services because they connect 90% of all wireless cell sites to the wireless carriers' switches. Moreover, the nation's critical Internet-based economic activity that rides on special access would be harmed.

Initial comments confirm that BOCs have frustrated every aspect of the Commission's public interest goals of special access pricing regime that sought to lower special access rates and spur innovative and improved services. Rather than a competitive marketplace that could achieve these goals, BOCs continue to possess a stranglehold over last mile facilities as CLECs are dependent on BOC special access service to access approximately 95% of customer locations. Contrary to the BOCs' claims, intermodal providers, such as cable operators, are not significant competitors in the special access market and most intramodal providers remain dependent on special access as well. The DOJ, GAO and the Commission recognize the extreme reliance the country has on the BOCs' special access facilities because there are no alternative competitive facilities deployed to a overwhelming majority of customers.

Because the BOCs remain monopoly providers of special access facilities, any regulatory relief they obtained under the Commission's failed pricing flexibility rules has resulted in substantial and sustained special access price increases. While the BOCs claim that revenues or average prices have declined on a voice-grade equivalent basis, a basic apples-for-apples rate comparison of special access rates reveals that rates have increased rather than decreased, as they would in a truly competitive market. This demonstrates the BOCs' theories are contrived and blatantly wrong.

The BOCs' rates-of return provide further proof the special access regime is fatally flawed. For instance, the BOCs' average rate-of-return for special access services based on ARMIS data was 77.86% in 2006 and, if corrected to address improper accounting of unregulated competitive broadband services with regulated special access services, it was an astounding 94.28%. These returns far exceed the 11.25 percent that the Commission would

otherwise expect and BOCs have failed to refute this by ignoring the Commission's request that they submit their own rate-of-return estimates.

Not surprisingly, the recent BOC mergers have made matters worse and have increased BOC monopoly power over special access services. The BOCs made much about the billions of dollars of savings associated with the mergers; however, none of these savings have reduced the prices for special access services. Nor is it surprising that the mergers have increased concentration of control of special access facilities. For this very reason, BOCs have no incentive to stop their unlawful practices of tying discounts to anticompetitive terms and conditions. The onerous terms and arrangements are discouraging, rather than fostering, facilities-based competition.

For the above reasons and despite the BOCs' expected objections, the Commission needs to act immediately and address the BOCs' exploitation of their market power. It should first reinitialize special access rates because forward-looking benchmark rates demonstrate the BOCs' special access rates far exceed any forward-looking zone of reasonableness for services in a competitive marketplace. The most efficient and pragmatic way to do this would be to set special access rates at forward-looking economic levels, using TELRIC rates as proxies. As an alternative, the Commission could invite BOCs to file forward-looking cost studies.

The Commission should also reform its price cap regime by including an X-factor, as recently proposed by Sprint, of 16.95 percent and sharing requirements. In addition, the special access rules should include not only separate baskets for DS1, DS3, OCn, mass market broadband and DSL, and retail special access but also specific categories for the DS1 and DS3 services. The Commission should concurrently abolish Phase II pricing flexibility and only

permit conditions on volume and term discounts that are reasonably related to costs or efficiencies of providing volume and term offerings. Finally, the Commission should adopt a "fresh look" so that customers locked in by current unreasonable BOC tariffs may choose another provider.

TABLE OF SHORT CITATIONS

FCC Decisions

AT&T-BellSouth Merger Order	*AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Doc. No. 06-74, Memorandum Opinion and Order, FCC 06-189 (rel. Mar 26, 2007)
Access Charge Reform Order	*Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982 (1997) (subsequent history omitted).
CALLS Order	*Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (subsequent history omitted)
LEC Price Cap Order	*Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (subsequent history omitted)
Omaha Forbearance Order	*Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. §160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, WC Docket No. 04-223, 20 FCC Rcd 19415 (2005)
Pricing Flexibility Order	*Access Charge Reform*, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (subsequent history omitted)
SBC-Ameritech Merger Order	*Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer of Control*, Memorandum Opinion and Order, CC Docket No. 98-141, 14

	FCC Rcd 14712, (1999).
SBC-AT&T Merger Order	*SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Doc. No. 05-65, Memorandum Opinion and Order, 20 FCC Rcd 18290 (rel. Nov. 17, 2005)
TRO	*Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003), *corrected by* Errata, 18 FCC Rcd 19020 (2003), *aff'd in part, remanded in part, vacated in part, United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied sub nom. Nat'l Ass'n Regulatory Util. Comm'rs v. United States Telecom Ass'n*, 125 S. Ct. 313 (2004)
TRRO or *Triennial Review Remand Order*	*Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (2005), *aff'd, Covad Commc'ns Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006)
Special Access NPRM	*Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, FCC 05-18 (rel. Jan. 31, 2005).
Verizon-MCI Merger Order	*Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, 20 FCC Rcd 18433 (2005)

August 8, 2007 Comments Cited

Ad Hoc Comments	Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
AT&T Comments	Supplemental Comments of AT&T Inc., WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
ATX *et al.* Comments	ATX Communications, Inc., Bridgecom International, Inc., Broadview Networks, Inc., Cavalier Telephone, LLC, Deltacom, Inc., Integra Telecom, Inc., Lightyear Network Solutions, LLC, McLeodUSA Telecommunications Services, Inc., Penn Telecom, Inc., RCN Telecom Services, Inc., SAVVIS, INC., and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Global Crossing Comments	Comments of Global Crossing North America, Inc., WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Qwest Comments	Comments of Qwest Communications International, Inc., WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Sprint Comments	Comments of Sprint Nextel Corporation, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Time Warner and One Comments	Comments of Time Warner and ONE Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Verizon Comments	Comments of Verizon, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
XO *et al.* Comments	Comments of XO Communications, LLC, Covad Communications Group, Inc., and NuVox Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)

Other Comments or Filings Cited

Ad Hoc 6/13/05 Comments	Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25, RM-10593 (filed June 13, 2005)
Ad Hoc 7/29/05 Reply Comments	Reply Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25, RM-10593 (filed July 29, 2005)
COMPTEL *et al.* 6/13/05 Comments	Comments of CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications, WC Doc. No. 05-25, RM-10593 (filed June 13, 2005)
Declaration of M. Joseph Stith (dated Oct. 4, 2004) (filed in RM-10593 Dec. 7, 2004)	Letter from David L Lawson, Counsel for AT&T, to Marlene H. Dortch, Secretary, RM 10593 (filed Dec. 7, 2004) (attaching, *inter alia*, "Declaration of M. Joseph Stith (October 4, 2004)")
ETI White Paper	Comments of the Ad Hoc Telecommunications Users Committee, Attachment A - Economics and Technology, Inc., *Competition in Access Markets: Reality or Illusion – A Proposal for Regulating Uncertain Markets* dated August 2004, WC Doc. No. 05-25 (filed June 13, 2005)
GAO Report	U.S. GENERAL ACCOUNTABILITY OFFICE, REPORT TO THE TO THE CHAIRMAN., COMMITTEE ON GOVERNMENT REFORM, HOUSE OF REPRESENTATIVES - TELECOMMUNICATIONS, "FCC NEEDS TO IMPROVE ITS ABILITY TO MONITOR AND DETERMINE THE EXTENT OF COMPETITION IN DEDICATED ACCESS SERVICES (November 2006)
Joint CLECs 6/13/05 Comments	Comments of ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecom, Inc., US LEC Corp, and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25, RM-10593 (filed June 13, 2005)

Joint CLECs 7/29/05 Reply Comments	Reply Comments of ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecomm, Inc., US LEC Corp, and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25, RM-10593 (filed July 29, 2005)
WilTel 7/29/05 Reply Comments	Reply Comments of WilTel Communications, LLC, WC Doc. 05-25, RM-10593 (filed July 29, 2005)

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360 Networks (USA), Inc., ATX Communications, Inc., Bridgecom International, Inc., Broadview Networks, Inc., Cavalier Telephone, LLC, Deltacom, Inc., Integra Telecom, Inc., Lightyear Network Solutions, LLC., McLeodUSA Telecommunications Services, Inc., Penn Telecom, Inc., RCN Telecom Services, Inc., SAVVIS, INC., and U.S. TelePacific Corp. d/b/a TelePacific Communications submit these Reply Comments in response to the Commission's

request that parties refresh the record in this proceeding.[1]

I. INITIAL COMMENTS CONFIRM THAT BOCS HAVE SUBVERTED PRICE CAP AND PRICING FLEXIBILITY GOALS

Initial comments confirm that BOCs have frustrated every aspect of the public interest goals that the Commission intended to achieve through price cap regulation as modified by pricing flexibility. Incentive regulation was intended to "advance the public interest goals of just, reasonable, and nondiscriminatory rates, as well as a communications system that offers high quality, innovative services" by means of price caps. It also included a system of checks and balances that permits ILECs that excel at achieving productivity gains "to retain reasonably higher earnings" above the prescribed reasonable rate-of-return.[2] (emphasis added). Incentive regulation would benefit consumers because the "downward pressure on price ceilings requires LECs to share the benefits of increased productivity with ratepayers in the form of lower rates."[3] Pricing flexibility was intended to rely on marketplace forces to produce rates for special access that were closer the forward-looking costs.[4] Implicit in the BOCs' support of price cap regulation and pricing flexibility was the promise that in exchange for the opportunity to earn reasonably higher returns they would provide consumers with innovative and improved services at lower prices.

As shown in initial comments refreshing the record, however, BOCs have subverted the Commission's public interest goals by treating pricing flexibility as an opportunity for

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[1] *Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking*, Public Notice, WC Docket No. 05-25, RM-10593, FCC 07-123 (rel. July 9, 2007).

[2] *LEC Price Cap Order*, 5 FCC Rcd 6786, ¶ 2.

[3] *Id*. ¶ 30.

[4] *See, e.g., Pricing Flexibility Order*, ¶ 2 and n.4.

gamesmanship and exploitation of flaws in the Commission's pricing flexibility rules.[5] The record shows that far from providing innovative and improved services at reduced prices, BOCS are gouging customers for both legacy services and new services.[6] Far from earning reasonably higher returns in exchange for price reductions, BOCs are earning unconscionable returns and raising prices. As discussed elsewhere in these comments, BOCs' gamesmanship is confirmed by the bogus revenue and voice grade equivalent comparisons they provide that mask price increases.

Consequently, customers of BOC-provided services are receiving none of the benefits of innovation and reduced prices that the Commission intended. For example, notwithstanding the enormous potential for efficiencies and innovation in use of copper facilities, as CLECs have demonstrated in other proceedings,[7] BOCs are doing no more than overcharging for these fully depreciated facilities. BOCs' price gouging for services provided over legacy copper by itself requires reinstitution of the regulatory reforms, especially reinitialization of prices, as requested in initial comments.[8] Nor have BOCs been particularly innovative in other respects in provision of special access service. Thus, BOC initial comments are remarkably free of any claim that price caps and pricing flexibility rules are responsible for significant introduction of innovative special access services.

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[5] ATX *et al.* Comments at 9-16; Sprint Comments at 8.

[6] ATX *et al.* Comments at 9-16; Ad Hoc Comments at 5.

[7] *See, e.g.*, Policies and Rules Governing Retirement of Copper Loops by Incumbent Local Exchange Carriers, BridgeCom International *et al.* Petition for Rulemaking and Clarification, RM-11358 (filed Jan. 18, 2007).

[8] ATX *et al.* Comments at 39-43.

The need for reform to undo (at least prospectively) the harm caused by BOCs' subversion of price caps and pricing flexibility rules is all the more urgent because of the expiration of the CALLS Plan on June 30, 2005. At most, the Commission intended the CALLS Plan to be a transition towards achieving the goal of forward-looking cost prices for access charges.[9] The Commission never intended that the special access rate levels produced under the CALLS Plan or that the 2004 X-factor freeze would be permanent. The Commission's failure to adopt interim relief as envisioned in the *Special Access NPRM* also shows the need for prompt implementation of the reforms requested by competitive carriers in initial comments.[10]

II. BOCS HAVE NOT SHOWN A COMPETITIVE MARKET FOR ACCESS TO CUSTOMER LOCATIONS

As the explained in opening comments, the current record proves that CLECs are dependent on BOC special access services at approximately 95% of their customer locations,[11] while BOC comments claim that CLECs can deploy their own facilities to provide access and that suitable wholesale alternatives exist in the marketplace,[12] these arguments are without merit and do not stand up to scrutiny. Regulators that have looked at the issue have concluded that BOCs remain dominant providers of last mile access. The Commission, the DOJ, and the GAO have all reached the same conclusion - that the BOCs maintain a stranglehold on the special access market through their control over bottleneck last-mile facilities. Certainly the Commission cannot ignore the substantial findings of the DOJ that concluded its review of the SBC/AT&T

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[9] *Special Access NPRM* ¶ 7.

[10] ATX *et al*. Comments at 39-53.

[11] *Id*. at 23.

[12] Verizon Comments at 14-20, AT&T Comments at 21.

and Verizon/MCI mergers that (1) "for the vast majority of commercial buildings" in their territory, SBC and Verizon are the only carriers that own last-mile connections to buildings;[13] (2) CLECs have built or acquired their own last-mile fiber optic connections for only a "small percentage of commercial buildings";[14] and (3) AT&T and Verizon remain the "dominant" providers "of Local Private Lines (special access)" in their service areas.[15]

As explained below, the BOCs' principal arguments in their comments do not permit the Commission to now ignore the DOJ's conclusions, or the most recent evaluations of competition for last mile facilities in the *TRO, TRRO and Omaha Order*, or the GAO Report.

A. Intermodal Providers are Not Significant Competitors in the Special Access Market

The BOCs contend that cable companies are now and will be soon competing heavily in the special access market with the BOCs.[16] These claims, however, are largely speculative and reliant more on marketing hyperbole and less on reality. Qwest, for example, cites Comcast's plans to invest and speculation by industry analysts.[17]

This rank speculation and marketing hype, however, does not withstand scrutiny. As an initial matter, cable operators do not offer wholesale access services to competitors,[18] and where they have facilities, they do not generally provide the service level guarantees that business

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[13] DOJ Complaint, USA v. SBC Communications and AT&T Corp., Civil Action No. 1:05CV02102, USDC, ¶ 15; DOJ Complaint, USA v. Verizon Communications, Inc. and MCI, Inc., Civil Action No. 1:05CV02102, ¶ 15.

[14] *Id*., ¶16.

[15] *Id*., ¶ 20.

[16] *See* Qwest Comments at 35-38.

[17] Qwest Comments at 37.

[18] *See* XO *et al.* Comments, Declaration of Ajay Govil, ¶¶ 22-24.

customers demand.[19] Similarly, the record confirms that fixed wireless is not currently a substitute for BOC last mile facilities because it has not been easy to deploy, it has serious operational and security concerns and because it is available only to a tiny percentage of business customer lines.[20] Wireless services referred to are usually microwave facilities that have limited utility. Sprint Nextel, for example, while reaching a deal with a fixed wireless provider for new 4G service to its cell sites noted that such service "does not replace any existing special access services … it obtains from the BOCs or other ILECs."[21]

The record, including the comments filed in this refresh round, simply confirms what the Commission already knows: the BOCs control access to the overwhelming majority of customer locations[22] and intermodal alternatives are not viable substitutes to their last mile facilities.[23]

B. BOC Criticisms of the GAO Report are Invalid

While the DOJ and the Commission have independently reached the same conclusion — that there are no alternative facilities deployed to the vast overwhelming majority of special

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[19] XO *et al.* Comments, Declaration of Ajay Govil, ¶ 24.

[20] XO *et al.* Comments, Declaration of Ajay Govil, ¶ 21; *See also* ETI White Paper at 23-24. (fixed wireless accounts for less than two hundredths of a percent of the special access market).

[21] Sprint Comments at 32.

[22] The Commission concluded that competing carriers were impaired absent unbundled DS1 transport, DS3 transport, and DS1 loops in all but 5.4%, 8.5%, and 0.5% respectively of BOC wire centers. *TRRO*, ¶¶ 5, 24, 115, 118-119, n.337, 126; 129-130, 146, 166, 171-174, 178-179 ("competitive deployment of stand-alone DS1-capacity loops is rarely if ever economic"); *TRO*, ¶¶ 386-387, 391-392.

[23] *TRRO*, ¶ 193 ("record contains little evidence that cable companies are providing service at DS1 or higher capacities," and in fact "suggests that most of the businesses served by cable companies are not large enterprise customers, but mass market small businesses that would never generate enough traffic to require a high-capacity loop.").

access customer locations nationwide (and that conclusion has been validated by the GAO), the BOCs still contend there are competitive alternatives.[24]

The GAO Report, issued in November of 2006, investigated competition for the BOCs' special access services and found competitive alternatives in only a small set of buildings.[25] the GAO reached the following conclusions regarding the presence of fiber-based alternatives to BOC last mile facilities:

- facilities-based competition to end users does not appear to be extensive and that competitive alternatives exist in a "relatively small subset of buildings";[26]
- In the 16 major metropolitan areas reviewed it concluded that "competitors are serving, on average, less than 6 percent of the buildings with at least a DS-1 level of demand";
- in "buildings identified as likely having companies with a DS-3 level of demand, competitors have a fiber-based presence in about 15 percent of buildings on average";[27] and
- For buildings with 2 DS-3s of demand, it found that competitors have a fiber-based presence in only 24 percent of these buildings on average.[28]

AT&T contends that the number of buildings served is irrelevant because the "existence of alternative facilities near a building" is enough.[29] This of course is not necessarily the case. It is almost never economical to extend a lateral to a building to serve a DS1 of demand. Verizon,

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[24] Verizon Comments at 14, AT&T Comments at 9-13.

[25] GAO Report at 12 & 19.

[26] *Id*. at 12 & 19.

[27] *Id*. at 12.

[28] *Id*.

[29] AT&T Comments at 53.

for example, explains it can deploy a lateral of one-quarter of a mile for less than $150,000.[30] But Verizon also estimates the recurring revenue necessary to justify a build of half the cost would be $3,000 per month.[31] CLECs typically receive $500/month[32] for a DS1 suggesting that, the GAO was right to ignore the construction of laterals. The GAO Report recognized this fallacy of the BOC argument when it found that "where demand for dedicated access is relatively small, such as buildings with less than three or four DS-1s of demand, it is unlikely to be economically viable for competitors to extend their networks to the end user."[33]

C. Intramodal Providers Remain Dependent on BOC Facilities

In initial comments, the undersigned competitive carriers presented declarations from CLECs,[34] showing their continued dependence on BOC UNEs or special access facilities in order to provide service to the overwhelming majority of their customers. As explained in those declarations, it is rarely economically feasible for competitive carriers to construct loops to serve

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[30] *But see* XO *et al.* Comments, Declaration of Ajay Govil, ¶¶ 14-19 (explaining XO's cost to extend laterals to buildings and that unlike the BOCs, XO lacks the ability to deploy without first having customer commit to sufficient level of revenue).

[31] Verizon Comments at 20 (claiming a lateral build cost of $72,000).

[32] *See* ALTS Comments, WC Doc. No. 04-313, Declaration of Richard Batelaan with Cbeyond, ¶ 5, (filed Oct. 4, 2004) ("88% of Cbeyond's customers purchase… a base package, priced at $500 a month."). Even if CLECs could receive $750 per month for a bundle of data and voice services provided over a DS1 (which they cannot) it would still be uneconomical to self deploy loops to provide services using a DS1 worth of capacity. *See* Comments of the Loop and Transport Coalition, WC Doc. No. 04-313, Declaration of Dan J. Wigger with Advanced Telecom, ¶ 21 (filed Oct. 4, 2004).

[33] Verizon Comments, at 20.

[34] *See* ATX *et al.* Comments at 25, Declaration of Steven Brownworth, DeltaCom, Inc., Declaration of Don Eben, McLeodUSA Telecommunications Services, Inc., and Declaration of Kevin Albaugh, Penn Telecom, Inc. (Declarations attached to ATX *et al.*'s Comments filed August 8, 2007).

customers at the DS0, DS1, or DS3 capacity levels and competitive carriers are rarely able to find alternatives to BOC last mile facilities to most customer locations.[35]

The record provides additional support for these claims. XO, for example, indicates its preference for deploying its own facilities or using competitive alternatives, but that "the vast majority of instances" this is not possible so it must rely on ILEC last mile facilities to connect to its customers.[36] As XO further explained, deploying loops to serve DS1 and DS3 customers is simply not economic, thus forcing XO (and other CLECs like XO) to rely almost exclusively on the BOC for last mile facilities to meet DS1 and DS3 level demand.[37]

Other BOC competitors are equally reliant on last mile BOC facilities. And since the Commission's adoption of the Pricing Flexibility regime in 1999 competitors have become even more dependent on the BOCs for such facilities.[38] While Verizon boldly claims that in the New York MSA there are one or more known fiber providers in the wire centers that comprise 80 percent of Verizon's special access revenues in that region,[39] Nextel was unable to obtain competitive bids for service to all but 43 out of 1500 (3%) of its cell sites in that same market.[40]

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[35] *See e.g., Omaha Forbearance Order*, ¶ 67 (concluding that Qwest was the only provider of wholesale access in MSA demonstrating the lack of alternatives to BOC last mile facilities.).

[36] XO *et al.* Comments, Declaration of Ajay Govil, ¶ 6.

[37] *Id*. ¶¶ 11-19.

[38] *See* Sprint Comments at 30 (Sprint in 2001 relied on the BOCs for 88% of DS1 circuits and 74% of DS3's; in 2006 those numbers are "96% and 84% respectively").

[39] Verizon Comments at 16.

[40] Sprint Comments at 31.

Likewise, in its 2007 RFP, Sprint received similar results, obtaining competitive bids on 569 out of 52,000 cell sites — just over one percent.[41]

The experiences of Sprint and XO, two of the large BOC competitors in the current marketplace, only underscores the comments of CLECs that frequently lack the same resources available to Sprint and XO with respect to facilities deployment. As the undersigned competitive carriers explained and demonstrated in the declarations attached to the initial comments, they remain beholden to the BOCs for provision of last mile facilities — as UNEs or as special access.[42]

III. PRICING FLEXIBILITY HAS RESULTED IN SUBSTANTIAL AND SUSTAINED SPECIAL ACCESS PRICE INCREASES

The Commission recognizes that the level of competition in a market can be determined based on whether there has been substantial and sustained price increases.[43] As demonstrated in earlier comments, the BOCs continue to possess market power in the provision of special access because they have maintained or raised their DS1 and DS3 special access rates when given pricing flexibility and have been able to both retain customers and increase sales in the wake of rising prices.[44]

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[41] *Id*.

[42] *See, e.g.*, ATX *et al.* Comments, Declaration of Steven Brownworth, ¶¶ 3-4

[43] *Special Access NPRM*, ¶ 73.

[44] ATX *et al.* Comments at 6, 9-11, Attachment 4; AD Hoc Comments, Declaration of Susan Gately, ¶ 17, Exhibits 1-2; Sprint Comments, Declaration of Bridger Mitchell, ¶¶ 54-55, Exhibit 1; Global Crossing Comments, Declaration of Janet Fischer, ¶ 5, Tables 1-4; Joint CLECs 7/29/05 Comments at 14-19; Ad Hoc 6/13/05 Comments, Declaration of M. Joseph Stith; COMPTEL *et al.* 6/13/05 Comments, Declaration of Janet Fischer; Joint CLECs 6/13/05 Comments at 10-13.

The BOCs argue that this is not so and that special access prices have decreased since the onset of pricing flexibility. Their assertions are identical to ones they made in 2005 and rest upon contrived and misleading "analyses" that have been fully refuted.[45] For instance, Verizon argues that Dr. Taylor's analysis shows that prices for special access have fallen as a whole since 2006 based on Verizon's average revenue per voice-grade equivalent ("VGE") argument.[46] Qwest makes a similar claim.[47] As Dr. Selwyn demonstrated, however, asserting that special access rates have declined on a VGE basis is flawed because substantial decreases in per-VGE prices are attributable to:

- The disproportionate increase in demand for very high capacity OCN services whose price, when expressed on a VGE basis, is substantially lower than the per-VGE price for services purchased as DS-1s or DS-3s;
- Increased use of optional pricing plan ("OPP") contracts that impose substantial volume and term commitments, coupled with large financial penalties, in exchange for "discounts" off the prevailing month-to-month pricing; and
- Inclusion of special access rate decreases resulting from annual price cap rate adjustments for services not subject to pricing flexibility in the "average revenue" figure.[48]

Consequently, the average revenue per VGE is not a reliable indicator of any "price decreases" for any given type of circuit.[49]

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[45] *See* WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶¶ 33-55.

[46] In making this argument, Verizon also argues that its VGE analysis was calculated after removing DSL and FiOS data revenues from the special access category because including these revenues but not their associated lines in the ARMIS special access category overstates the revenues per line. Verizon Comments at 11. As Dr. Selwyn demonstrated, however, Dr. Taylor's removal of these revenues is based on undocumented and unreproducible data. *See* WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶¶ 48-49.

[47] Qwest Comments at 46 (referencing DS0 equivalents which is the same as a VGE).

[48] *See* WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶ 39.

[49] *Id.*

The BOCs also claim that their average special access prices or revenues for DS1 and DS3 services have generally declined.[50] As Dr. Selwyn previously demonstrated, however, these analysis are also flawed because: (1) they inappropriately treat mere shifts of relative demand from month-to-month to more anticompetitive and customer-constraining term and volume contracts as reflecting price changes; (2) they inappropriately combine price changes for price capped special access services with pricing flexibility services and interpret price decreases in special access services subject to price caps as price decreases for services for which the BOC has pricing flexibility; and/or (3) they inappropriately treat mere relative shifts in demand for circuit-mileage as price changes.[51]

Qwest and AT&T further contend that the actual rates customers must pay (not the rack rate list prices) are the appropriate starting point for any pricing analysis.[52] Besides amounting to an apparent admission that their non-discounted prices have risen, substantial evidence in the record shows that BOCs' "actual" special access prices have generally risen across the board absent the AT&T/SBC, Verizon/MCI and AT&T/BellSouth merger conditions. Moreover, rack rates are pertinent to evaluating the effective rates that customers pay because termination penalties are frequently tied to rack rates, not the discounted rates.

Verizon and AT&T go on to mischaracterize the GAO Report as though it only concluded "the decrease [pricing flexibility rates] appears to be consistent with the prospect of

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[50] AT&T Comments at 22; Qwest Comments at 46, Verizon Comments at 12.

[51] WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶¶ 46, 52, & 54.

[52] Qwest Comments at 48; AT&T Comments 36; Verizon Comments at 11.

competition that the FCC predicted."[53] They fail to mention, however, the GAO's finding that "prices and average revenues are higher, on average, in phase II MSAs--where competition is theoretically more vigorous--than they are in phase I MSAs or in areas where prices are still constrained by the price cap."[54]

If, as the BOCs claim, special access prices have been dropping where they received phase II pricing flexibility, they should have been able to show via a direct "apples-for-apples" comparison of actual tariff prices at various points in time, rather than by means of the indirect- and inapposite-device of an average revenue surrogate.[55] Of course, this type of comparison has been submitted by special access purchasers on numerous occasions in this proceeding and they disprove the BOCs' claims and show that phase II pricing flexibility rates reflect substantial and sustained price increases.[56] It is hardly surprising the BOCs needed to devise this "smoke and mirrors" approach to "prove" what in fact is not true.[57]

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[53] AT&T Comments at 22-23 (quoting GAO Report at 13); *see also* Verizon Comments at 13.

[54] GAO Report at 13.

[55] WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶¶ 38 & 46.

[56] *See, e.g.*, AD Hoc Comments, Declaration of Susan Gately, ¶ 17, Exhibits 1-2; ATX *et al.* Comments, at 6, Attachment 4; Sprint Comments, Declaration of Bridger Mitchell, ¶¶ 54-55, Exhibit 1; Global Crossing Comments, Declaration of Janet Fischer, ¶ 5, Tables 1-4; Ad Hoc 6/13/05 Comments, Declaration of M. Joseph Stith; COMPTEL *et al.* 6/13/05 Comments, Declaration of Janet Fischer. Notably, the Commission recognizes that "a substantial price increase need not be a large increase" but can be a "small but significant non-transitory price increase in the relevant product market." *Special Access NPRM*, n.188. As previously explained in Joint CLECs' comments (Joint CLECs 6/15/05 Comments at 11), to the extent BOCs have not increased their special access rates and have kept them at pre-pricing flexibility levels, the fact that BOCs are maintaining such rate levels is "tantamount to a price *increase* in light of the declining costs of special access service…." *See* Ad Hoc 6/13/05 Comments, Declaration of M. Joseph Stith, ¶ 17 (dated Oct. 19, 2004).

[57] WILTEL 7/29/05 Comments, Reply Declaration of Lee Selwyn, ¶ 46.

IV. ARMIS DATA PROVIDES SUBSTANTIAL EVIDENCE THAT THE BOCS ARE EXERCISING MARKET POWER OVER SPECIAL ACCESS SERVICES AND OBTAINING INCREASING SUPRACOMPETITIVE PROFITS AND RETURNS

As demonstrated in earlier comments, the BOCs' extraordinarily high special access rates-of-return clearly show that the Commission's regulatory framework governing special access pricing is not producing just and reasonable rates and that BOCs retain market power over special access services.[58] As they argued in 2005, the BOCs assert that ARMIS rate-of-return data is flawed and unreliable, and should not be used to assess their market power or for ratemaking purposes.[59] For the reasons explained below and as the record fully and already demonstrates,[60] the BOCs' criticisms can be readily rejected.

First, the BOCs argue that the ARMIS cost and accounting data are based on arcane and arbitrary allocations associated with jurisdictional separations, common costs, and divisions between regulated and unregulated services.[61] Contrary to these assertions, the allocations along

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[58] ATX *et al.* Comments at 11-15; Joint CLECs 7/29/05 Comments at 10-14; Joint CLECs 6/13/05 Comments at 7-10.

[59] *See* AT&T Comments at 34-37; Qwest Comments at 50-53; Verizon Comments at 41-45.

[60] *See, e.g.*, Joint CLECs 7/29/05 Comments, at 10-14.

[61] AT&T Comments at 35; Qwest Comments at 51; Verizon Comments at 43. Verizon also argues that the Commission should ignore ARMIS rates-of-return for special access because any focus on costs would effectively revert to rate-of-return regulation. Verizon Comments at 42. Contrary to Verizon's assertions and the Commission's predictive judgment, however, competition has failed to materialize and constrain the BOCs' monopolistic pricing behavior. Consequently, the Commission is compelled to intervene and set prices that are just and reasonable for services that ILECs have a monopoly over and allow for a reasonable rate of return. The Commission has emphasized that if forward-looking prices failed to materialize it would be compelled to reinitialize special access rates, which is rate-of-return ratemaking. *See See, e.g., Access Charge Reform Order*, ¶ 48 (emphasizing "Where competition has not emerged, we reserve the right to adjust rates in the future to bring them into line with forward-looking costs").

with the cost and revenue data they report to the FCC through ARMIS, are neither arcane nor arbitrary.[62] "It is 'regulatory' accounting data developed according to a strict set of accounting rules established by utility accounting experts."[63] These rules are specifically designed to differ from the financial accounting data the BOCs report to their shareholders and the SEC.[64] Ironically, if financial accounting were applied instead of regulatory accounting, the rates-of-return would likely be higher than those already reported to the Commission.[65] Significantly, ARMIS reporting is done at the service category level. As a result, certain categories of cost that support multiple services, such as switched and special access services, must be allocated among the relevant services.[66] While the allocations may be less than precise, that does not make them inaccurate or useless for the purpose of regulatory analysis, which is why they were originally established.[67]

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[62] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at Appendix 1 at A-3.

[63] *Id*.

[64] *Id*.

[65] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at Appendix 1 at A-3.

[66] *Id*.

[67] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at Appendix 1 at A-3. Verizon also asserts that its total company return for regulated services was 9.78%, although ARMIS return for all regulated interstate services was 21.21 percent (4.297 percent for the traffic sensitive component, 9.29 percent for the common line component, and 51.39 percent for the special access component). Verizon Comments at 43. Verizon claims that this disparity suggests (when its total regulated services are considered as a whole) its returns are well within reasonable levels in an intensely competitive telecommunications market. *Id*. Contrary to Verizon's claims, this shows that Verizon is subsidizing its competitive offerings with revenues from its noncompetitive offerings. Such actions are contrary to forward-looking cost-based pricing reflective of a competitive market and have never been condoned by the Commission.

Second, the BOCs argue that ARMIS data was never used to set prices: "evaluating earnings levels though analysis of regulatory accounting data *is not setting prices*."[68] Their arguments also strain credulity because the BOCs have repeatedly embraced ARMIS data when it benefits them for ratemaking purposes. As Economics and Technology, Inc. ("ETI") and others have explained, the BOCs in other contexts have emphasized the tremendous value and utility of ARMIS data for ratemaking purposes.[69] Indeed, the BOCs are quick to discredit ARMIS data when it demonstrates that they are over-earning, but they nonetheless are more than happy to offer it to regulators as showing that UNE prices are too low.[70] In any event and as discussed below, record evidence shows that even if there are any misallocations, it is more likely that costs from other ILEC services are being improperly assigned to special access and that the rates-of-return are higher.[71]

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[68] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, Appendix 1 at A-3 (emphasis added).

[69] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, Appendix 1 at n.41; *see also* Ad Hoc 6/13/05 Comments at 29; ETI White Paper at 30 &n.56; Joint CLECs 7/29/05 Comments at 10-11.

[70] *See id.*

[71] ETI White Paper at 33; *see also* Ad Hoc Comments, Declaration of Susan Gately, ¶ 15. ETI explained that for 2003, the new investment allocated to the special access category for the four BOCs was roughly one third of their total interstate net investment and approximately 40% of their combined Common Line and Special Access Investment categories. Ad Hoc 8/8/07 Comments, Declaration of Susan Gately, ¶ 15. ETI noted that because there are fewer than 4-million special access loops and associated interoffice transport facilities, compared to more than 158-million Common Line local service loops in the BOCs' operating territories, the allocated investment is entirely disproportionate to the number of special access loops, as a percentage of total loops in service. *Id.* Thus, the wide discrepancy between the number of loops used for special access and the amount of interstate investment assigned to those loops certainly raises suspicions that costs are being over-allocated to the special access category. *Id*. 2005 data confirms this. *Id*.

Third, the BOCs continue to argue that the 2001 separations freeze of ARMIS cost categories distort any attempt to use these data to approximate special access rates-of-return. There is, however, no evidence that this separations freeze resulted in an under-allocation of expenses or investments to the special access category.[72] The BOCs essentially assert that because of the freeze, the growth in special access demand (lines or revenues) has been greater than the growth in special access investment, and that the different growth rates presents proof that special access investment and expenses are being under allocated to the special access category.[73] Their argument does not survive scrutiny because there should be no expectation that the rates of change in special access "demand" and "investment" levels will be in the same proportion as one another.[74] For example, a special access customer subscribing to a single OC-3 line (2,016 VGEs) who decides to purchase additional bandwidth and replaces the OC-3 with an OC-12 (8,064 VGEs) increases the special access VGE demand by 300%, yet an OC-12 costs only a small amount (as little as 5% to 10%) more than an OC-3.[75]

In any event, even if ARMIS rates-of-return are not ideal (because of the alleged misallocations noted by the BOCs),[76] the trend in the data, as shown in earlier comments, is steadily rising and is a reliable indicator of the BOCs' ability to increase prices to

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[72] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at Appendix 1 at A-5.

[73] *Id*.

[74] *Id*.

[75] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at Appendix 1 at A-5; *see also* Ad Hoc Comments, Declaration of Susan Gately, ¶ 16 (explaining that the costs of special access services are trending down much more so than rates on a VGE equivalent basis).

[76] ATX *et al.* Comments at 12-13.

supracompetitive levels without fear of attracting competitive entry.[77] Moreover, despite the BOCs' criticisms about the allocations, they are still experiencing phenomenal interstate rates-of-return overall. For instance, the BOCs' average interstate rate of return for 2006 was 26.13%.[78] This return is considerably more than double the Commission's prescribed 11.25 percent rate of return "benchmark for determining whether price cap LECs' special access rates are just and reasonable."[79] Moreover, the fact that the 11.25 percent rate of return is outdated and should be in the 8 percent range[80] further proves that the BOCs' earnings are excessive by any standard..[81] As emphasized in earlier comments, the Commission must recognize that where there is smoke there is fire and in this case, "plumes of excessive earnings have been ignited and fueled by the BOCs excessive and unreasonable special access rates."[82]

Fourth, if anything, the BOCs' average rates-of-return are likely significantly understated. As ETI recently emphasized, special access and other regulated services rates-of-return as reported in ARMIS are almost certainly being understated due to the inclusion of RBOC capital expenditures made for the purpose of offering unregulated broadband and video services, such as Verizon's FiOS and AT&T's Project Lightspeed, within the "regulated

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[77] *Id*. at 14; *see also* ETI White Paper at 29; Joint CLECs 7/29/05 Comments at 13.

[78] ARMIS Report 43-01, Table I, Column (h), Row 1915/Row 1910; Ad Hoc Comments, Declaration of Susan Gately, ¶ 6, Updated Table 1.1; ATX *et al.* Comments at 14.

[79] *Special Access NPRM*, ¶ 60.

[80] Joint CLECs 6/13/05 Comments at 23; *see also* Ad Hoc Comments at 24.

[81] *See also* Ad Hoc 6/13/05 Comments at 41-42.

[82] Joint CLECs 7/29/05 Comments at 13.

services" category.[83] Adjusting ARMIS reported special access category investment so that it excludes non-regulated broadband investments from the regulated services category increases the BOCs' average special access rate-of-return of 77.86% to 94.28%.[84]

Finally and despite the BOCs' misallocation arguments, the Commission invited the BOCs back in 2005 to re-run the numbers by (1) "remov[ing] from the BOCs' interstate special access operating expenses and average investment data reported in ARMIS any expenses and investments that are not directly assignable;" and (2) "calculat[ing] the compound annual growth rates for BOC interstate special access operating expenses and average investment using these adjusted data."[85] Rather than re-calculating the ARMIS rates-of-return as the Commission requested back in 2005, the BOCs continue, more than two years later, to throw up a smoke screen by casting aspersions on the ARMIS data itself. Their actions are unpersuasive because the BOCs have the means to estimate readily what their special access rates-of-return would be based on their challenges and criticisms about the allocations. Absent such re-calculations, there should be a presumption that they are unable to controvert ARMIS rates-of-return and that they are likely experiencing profits that equal or exceed such levels.[86]

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[83] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at 16-18 and Appendix 1 at A-8 through A-10.

[84] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at 18.

[85] *Special Access NPRM*, ¶ 29.

[86] *See* Joint CLECs 7/29/05 Comments at 12. As Joint CLECs emphasized previously, any re-calculations would likely also reveal a relationship with demand growth and growth in expenses and investment that "suggest [] that BOCs realized scale economies." Joint CLECs' 7/29/05 Comments at 12 (quoting COMPTEL *et al.* 6/13/05 Comments at 6). Because the BOCs can meet ever-increasing demand for their special access services on an incremental cost basis, the failure of the BOCs to flow through their economies of scale to the consumer and carrier market has led to excessive rates-of-return. *Id*. In a competitive market, or even under the Commission's previous price cap rules, consumers would see the effects of such efficiency gains

For the above reasons, ARMIS data remains a reliable indicator that BOC special access prices are unreasonable and reflect the lack of competitive alternatives to the BOCs special access services.

V. BOCS HAVE NOT REBUTTED THE NEGATIVE IMPACT OF THE MERGERS

Not surprisingly, numerous commenters agree that the recent BOC mergers have significantly increased the BOCs' monopoly power over special access. At the same time, none of the BOCs have attested to any benefits of the mergers to competition in special access. One would have expected that the BOCs would have been touting the economies and efficiencies of their recent mergers, and how these had contributed to the purported reduction in special access rates. Rather, the BOCs now downplay the asserted merger efficiencies that they touted when seeking approval of the mergers. For example, Verizon now states that "*[i]n theory*, mergers can lead to a decrease in unit costs through synergies in network investment and deployment, network operations, or marketing. . . . However, for point-to-point special access services, it is not obviously the case that the recent mergers will have a significant impact on network unit costs."[87] AT&T also dissembles, stating that "[t]here are no significant economies of scale associated with channel terminations, which require a separate connection to each building and end user, and there was, in any event, relatively little building overlap between legacy AT&T and legacy SBC and BellSouth (or between MCI and Verizon)."[88]

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in the form of lower prices. *Id*. However, as demonstrated, the BOCs have increased prices or kept them the same where they have been granted pricing flexibility.

[87] Verizon Comments, Supplemental Declaration of William Taylor at 14 (emphasis supplied).

[88] AT&T Comments at 46, n.99.

Interestingly, none of these caveats appeared in public interest statements supporting the mergers. Verizon promised $7 billion in savings, partly on the basis of "[t]he cost reductions will come from eliminating duplicative network facilities, staff, and information and operation systems, reducing procurement costs, rationalizing the companies' real estate assets, and more efficiently using existing networks."[89] AT&T raised expectations of savings approaching $15 billion through "elimination of duplicate facilities; elimination of overlapping staff and related administrative expenses; consolidation of billing and operating support systems; greater utilization of network assets by combining the companies' traffic streams (especially as applications increasingly become IP); greater scalability from business process improvements (including mechanization functions and higher flow-through rates); improved pricing from equipment and service providers; greater scalability from standardization and automation of IT systems and elimination of duplicative IT development projects; and reduction of off-net third party network expenses."[90] These statements certainly imply that the cost savings would be broadly distributed. It is disappointing to hear now that these tens of billions of dollars in cost savings were somehow totally inapplicable to special access services, especially since there are so few competitive alternatives.

AT&T also grossly mischaracterizes the Commission's findings in the *SBC-AT&T* and *Verizon-MCI Merger Orders* when it states that "both the Commission and the Department of Justice have already recognized that the recent AT&T and Verizon mergers could have no

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[89] Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Public Interest Statement at 15 (filed Mar. 11, 2005).

[90] SBC Communications, Inc. and AT&T Corp. Applications for Approval of Transfer of Control, WC Docket No. 05-65, Public Interest Statement at 44 (filed Feb. 22, 2005).

adverse competitive impact on the provision of special access services in any market given the commitments of AT&T and Verizon to divest fiber connections to 100 percent of the commercial buildings formerly served only by the merging parties that were deemed unlikely candidates for additional competitive special access connections."[91] Actually, the Commission's findings in both cases were much more restricted. Far from curing anticompetitive effects in "any" market, the fiber divestiture was only targeted at the specific instances in which each carrier was "the only carrier besides [the BOC] that is directly connected to a particular building."[92] Hence, the DOJ in the consent decree required that each BOC "divest IRUs to those buildings where it was the sole CLEC with a direct connection to the building and where DOJ found entry unlikely."[93]

The BOCs' comments have done nothing to rebut the consistent message that their mergers would have negative impacts on competition. Certainly, none of the BOCs have touted merger efficiencies as reducing rates, and in fact, they make excuses. To the extent that the mergers have served to control special access rates, a significant factor has been the merger conditions to which they agreed, under pressure. Although AT&T touts this as evidence of special access rate decreases,[94] it demonstrates only that the sole definite method of correcting the market failure in the special access market is through Commission intervention. Once the transitory effect of the merger conditions disappears, AT&T and Verizon will be free to continue raising special access rates, absent further Commission intervention.

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[91] AT&T Comments at 45.

[92] *SBC-AT&T Merger Order*, ¶ 37; *Verizon-MCI Merger Order*, ¶ 37.

[93] *SBC-AT&T Merger Order*, ¶ 40; *Verizon-MCI Merger Order*, ¶ 40; *AT&T-BellSouth Merger Order*, ¶ 36.

[94] AT&T Comments at 22.

VI. BOCS HAVE NOT JUSTIFIED ANTICOMPETITIVE TERMS AND CONDITIONS

Strikingly absent from the BOCs comments is any attempt to justify their current practices of tying discounts to anticompetitive terms and conditions. While offering the non-controversial statements that discounts can benefit customers,[95] neither AT&T, Qwest, or Verizon attempt to justify their current practices of tying discounts to, for example, regional commitments and restrictions on purchasing UNEs. By default, BOCs have conceded that there is no justification for these requirements. As explained in initial comments, BOCs are able to impose these anticompetitive terms and conditions because they possess bottleneck control to last mile facilities.[96] Although BOCs' failure to address their current unreasonable terms and conditions has not inhibited Verizon from requesting that the Commission rescind limits on growth discounts, the Commission should deny that request as discussed in section VIII below.

VII. THE JOINT CLECS' REQUESTED REFORMS SHOULD BE IMPLEMENTED PROMPTLY

A. Reinitialization is Critically Necessary Because Forward-Looking Benchmarks Demonstrate the BOCs' Special Access Rates are Well Above Any Zone of Reasonableness

As Joint CLECs previously explained, the Commission's predictive judgment that competition would by now have forced special access prices closer to the Commission's goal of forward-looking economic costs was erroneous.[97] AT&T argues that parties have failed to

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[95] AT&T Comments at 27; Verizon Comments at 7.

[96] ATX *et al.* Comments at 23.

[97] Joint CLECs 6/13/05 Comments at 5; *see also* ATX *et al.* Comments at 39.

explain why any benchmark could lawfully be used to show this[98] and that special access rates already exist in a zone of reasonableness.[99]

Contrary to AT&T's assertions, the BOCs' special access rates far exceed the statutory zone of reasonableness. AT&T's arguments entirely ignore the fact that special access rates should fall within a zone that reflects the forward-looking costs of providing services in a competitive marketplace and not within a zone that reflects confiscatory levels a monopolist can extract from its customers. The record fully shows that the BOCs' special access rates far exceed a benchmark comparison of forward-looking TELRIC-based rates for functionally equivalent DS1 and DS3 services that would exist if the marketplace were truly competitive.[100] The BOCs rates also dramatically exceed the rates Competitive Access Providers (CAPs) offer for similar services.[101] In fact, "price cap and pricing flexibility rates are typically two to three times higher" than what competitive carriers offer for an equivalent service.[102]

Moreover, if anything, these forward-looking rates are on the high end of any zone of reasonable rates for DS1 or 1.544 Mbps services that Section 201 would allow. Record evidence shows that the BOCs are charging their *retail customers* between $30 and $40 a month for

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[98] AT&T Comments at 31.

[99] *Id*. at 32-34, 38.

[100] *See* ATX *et al.* Comments, Attachment 4; Sprint Comments Declaration of Bridger Mitchell, ¶ 57, Exhibit 3; XO *et al.* Comments at Attachment 2; *see* Letter from Brett Heather Freedson, Kelly Drye & Warren, LLP, to Marlene Dortch, Secretary, FCC, WC. Doc. No. 05-25, RM-10593 (filed Aug. 10, 2007) (attaching an errata); Declaration of M. Joseph Stith (dated Oct. 4, 2004) (filed in RM-10593 Dec. 7, 2004).

[101] Global Crossing Comments, Declaration of Janet Fischer, ¶ 6, Tables 5-6.

[102] *Id*.

services reaching much higher speeds of 2 to 5 Mbps.[103] Given this, a forward-looking cost structure that applies to the BOCs' DS1 special access services should result in wholesale rates that are *lower, not higher* than what the BOCs currently charge their retail customers for comparable services. For these reasons, reinitializing special access rates is imperative.

B. Reinitializing Special Access Rates at Cost-Based, Forward-Looking Levels Using State-Approved TELRIC Rates as Proxies is Appropriate, Especially If BOCs Have the Option of Filing Forward-Looking Cost Studies

Since the Commission has already concluded that "access charges should ultimately reflect [forward-looking] rates that would exist in a competitive market"[104] and as proposed in earlier comments, special access rates should be reinitialized and set at these levels.[105] To accomplish this objective, the Commission should take a pragmatic and easily administrable approach that involves setting special access prices at state-approved TELRIC rates for comparable UNEs.[106] If the BOCs believe that TELRIC rates do not cover their costs (which is highly unlikely given the above), the Commission could invite them to file forward-looking cost studies instead.[107]

AT&T argues that if the Commission were to set special access rates, it would need to start from scratch and that a rate investigation would trigger costly and extensive litigation.[108] It

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[103] Qwest Comments at n.62; Sprint Comments at 23-24.

[104] *See Access Charge Reform Order*, ¶ 72.

[105] Joint CLECs 6/13/05 Comments at 18; ATX *et al.* Comments at 39.

[106] Joint CLECs 6/13/05 Comments at 17-22; ATX *et al.* Comments at 39-43.

[107] The Commission previously permitted the BOCs to do this (which they elected not to do) and instead they opted for other alternatives that were available to them. *See CALLS Order*, ¶¶ 29, 56-62; *Special Access NPRM*, ¶ 14.

[108] AT&T Comments at 38, 57-60.

contends, among other things, the Commission would have to establish joint and common cost allocations, which would be difficult if not impossible to defend, and a new rate of return.[109] In making these arguments, AT&T implicitly acknowledges that commissions in virtually every state, including the Wireline Competition Bureau with respect to the Virginia arbitration, previously faced and were able to handle the complexities associated with establishing forward-looking TELRIC rates.[110] Hence, the issues are far from insurmountable and problematic as AT&T alleges, although it is true that cost proceedings may be expensive, time consuming and administratively burdensome.

For this very reason, reinitializating special access rates to TELRIC rate levels makes perfect sense. As emphasized in earlier comments, this effort has already been undertaken in TELRIC UNE cost proceedings throughout the nation.[111] Moreover, the Commission has reviewed the rates in the context of 271 proceedings and found that they were within a forward-looking zone of reasonableness.[112] Thus, reinitializing special access rates as does not at all involve undue administrative burdens.[113] Rather, it would be administratively more efficient to make this option available to the BOCs than requiring them to file forward-looking special access cost studies and having to conduct proceedings investigating them.

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[109] AT&T Comments at 59.

[110] *Id*. at 58.

[111] Joint CLECs 6/13/05 Comments at 20.

[112] ATX *et al.* Comments at 41-42; Joint CLECs 6/13/05 Comments at 20.

[113] ATX *et al.* Comments at 43; Joint CLECs 6/13/05 Comments at 21.

As proposed, if the BOCs do not find this approach appealing and would rather have their rates investigated, the Commission could invite them to file forward-looking cost studies.[114] While AT&T suggests this approach would expose the Commission to a host of burdensome ratemaking issues, the Commission has years of experience in investigating and establishing rates and is well situated to handle these rate investigations efficiently.[115] It appears that AT&T overlooks the axiomatic fact that since the Commission was established, rate regulation of interstate communications (which includes interstate special access services) has been one of its basic responsibilities. Moreover, if AT&T, Verizon, and Qwest were to file cost studies with the Commission, this approach would be much less administratively burdensome than the state TELRIC proceedings. There would only be three proceedings rather than the fifty or more proceedings before state commissions that took place when UNE rates were first established. Furthermore, even though a full and thorough Commission investigation of the BOCs' special access rates would come with certain costs and burdens, there is no question they would be justified, especially since the record shows the BOCs' overcharges yielded $8.31 billion in excessive special access revenues or 22.77 million in overcharges per day in 2006 and that their excessive special access rates would deprive the US economy of some 234,000 new jobs and GDP growth in the range of $66 billion.[116] In any event, BOCs taking this approach should recognize the risks associated with a rate investigation and that it could ultimately require them

[114] ATX *et al.* Comments at 43; Joint CLECs 6/13/05 Comments at 22.

[115] AT&T Comments at 57-60.

[116] Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at i; ATX *et al.* Comments at 14.

to reduce their special access rates to UNE rates or below and refund past overcharges for special access services.[117]

AT&T also argues that any re-initialization and re-regulation would be "inconsistent with the core premises of price cap regulation" and will undermine the credibility of the incentive-based system.[118] This claim is ironic because the credibility and effectiveness of an incentive-based system has been destroyed by the BOCs themselves. While price cap regulation was designed "to replicate efficiency incentives of a competitive market"[119] and punish inefficient behavior, this goal has unfortunately not been realized. Instead, price cap regulation, combined with pricing flexibility, has rewarded monopolistic behavior and punished consumers with unreasonable special access rates, which has adversely impacted the entire economy.[120] The record clearly shows that pricing flexibility rates are higher than price cap rates, not to mention the rates that would otherwise be likely available if the special access market were truly competitive.

In addition, AT&T submits that re-initializing prices will not inspire BOCs to operate more efficiently.[121] This claim is also unavailing. In economic terms, it should be incentive

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[117] Since substantial evidence demonstrates that special access rates are unreasonable, such retroactive true-ups would be permissible. *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384, 387-89 (1932) (A carrier charging a merely legal rate (in that it was properly filed) may be subject to refund liability if customers can later show that the rate was unreasonable. Should an agency declare a rate to be lawful, however, refunds are thereafter impermissible as a form of retroactive ratemaking); *see also Verizon v. F.C.C.*, 453 F. 3d 487 (D.C. Cir June 20, 2006); *Virgin Islands v. F.C.C.*, 444 F.3d. 666 (D.C. Cir. Apr. 11, 2006).

[118] AT&T Comments at 31.

[119] *Id*.

[120] *See* Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy.

[121] AT&T Comments at 32.

enough for any business to achieve rates-of-return that are realistically obtainable in a competitive marketplace. Only a monopoly can expect more and the fact BOCs have such expectations is proof that they face little or no competition in the special access market.

AT&T further asserts that any re-initialization will be an arbitrary action.[122] This claim has no merit either because it flies in the face of the careful and studied manner in which the Commission has addressed special access rate regulation in the last fifteen years. As early as 2002, it became apparent that the Commission's pricing flexibility rules were not having the intended effect when the Commission opened RM-10593 and evidence submitted since then further demonstrates the Commission's predictive judgment failed miserably. A course-correction made necessary by the wide divergence between expectations and results is by no means "arbitrary," and is in fact the Commission's duty[123] and there are significant economic benefits in doing so.[124] Moreover, any reasonable business should realize that, far from being

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[122] *Id*. at 38.

[123] *See Bechtel v. FCC*, 957 F.2d 873, 881 (D.C. Cir. 1992) ("The Commission's necessarily wide latitude to make policy based upon predictive judgments deriving its general expertise implies a correlative duty to evaluate its policies over time to ascertain whether they work – that is, whether they actually produce the benefits the Commission originally predicted they would."); *ACLU v. FCC*, 823 F.2d 1554, 1565 (D.C. Cir. 1987) (the D.C. Circuit has specifically "emphasize[d] the need for the Commission to vigilantly monitor the consequences of its rate regulation rules" where, as here, "the Commission itself has recognized the tentative nature of its predictive judgments."); *see also BellSouth v. FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2006) (finding that "the deference owed agencies' predictive judgments gives them no license to ignore the past when the past relates directly to the question at issue.").

[124] *See* Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, at i; *see also* Letter from Brian R. Moir, Partner, Moir & Hardman, to Marlene H. Dortch, Secretary, FCC, RM-10593 (June 12, 2003) (attaching macroeconomic analysis of the impact on the U.S. economy if excessive special access prices were lowered to reasonable levels. This study demonstrated that by reducing special access rates to levels that would produce an 11.25% return would result in immediate positive benefits by adding $14.5 billion to the U.S. economic output (Gross Domestic Product) and by creating 132,000 new jobs in the first two years.).

arbitrary, such an action is inevitable, forced as it is by the BOCs' continued abuse of their pricing flexibility.[125]

C. The Record Supports Modifying the X-Factor

Once special access rates are reinitialized and as proposed in earlier comments, the Commission should include all special access rates under a modified price cap regulatory framework[126] and make a productivity-based X-factor a key feature of such new rules. Because the BOCs threaten to reduce their investment in network efficiencies in the face of new price caps, it is even more important that the Commission reinstitute an X-factor to ensure that BOCs capitalize on the technological advancements of their suppliers so that their special access productivity improves.[127]

AT&T contends there is no basis for modifying the X-factor and that the Commission's current rules contain a robust X-factor for special access services. AT&T asserts that the rules freeze the price cap rates and prevent price cap ILECs from raising rates to counter the very real effects of inflation.[128] Contrary to AT&T's claims, the record fully supports modifying the X factor because BOCs enjoy productivity levels significantly greater than the economy as a whole. As explained in earlier comments, it would be inappropriate to set the X-factor at the inflation

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[125] AT&T also argues the Commission cannot reinitialize special access rates in isolation and would have to concurrently take a fresh look at switched access rates, where ARMIS returns are very low. AT&T Comments at 38. Contrary to AT&T's claim, the Commission can establish the rates independent from one another. Just as AT&T filed its Petition for Rulemaking back in 2002 that initiated this proceeding, AT&T can likewise file another one requesting the commencement of a rulemaking proceeding for switched access rates.

[126] Joint CLECs 6/13/05 Comments at 24-32; ATX *et al.* Comments at 44-49. This involves bringing all special access services in existing Phase II MSAs back within price caps.

[127] *See also* Joint CLECs 7/29/05 Comments at 43-44.

[128] AT&T Comments at 39.

rate because BOC customers would not see the reduced rates associated with productivity gains.[129]

AT&T also asserts that there no evidence in the record that the existing X-Factor is "so grossly off-target" that the Commission needs to establish a new one.[130] The ETI study presented in 2005 demonstrated, however, that an X-factor of approximately 11 percent would be appropriate.[131] Moreover, the 2007 study that Sprint submitted, which updates the 2005 ETI study, shows that the BOCs' interstate special access productivity continues to outstrip productivity gains in the economy as a whole and supports an X-factor of 16.95 percent.[132] While AT&T claims the ETI study is unsound because it relies on historical ARMIS data and assumes an 11.25 percent rate of return, its criticisms of ARMIS data are unavailing as shown elsewhere herein and the 11.25 percent rate of return should (if anything) be reduced, which in turn would produce an even higher X-factor. The productivity gains associated with the BOC mergers, which have yet to be taken fully into account, would as well.

AT&T further claims that it would be "lunacy" for the Commission to establish a new X-factor in the face of the litigation the Commission would confront defending it and cites to the D.C. Circuit's 1999 rejection of the Commission's 1997 revisions to the X-factor formula.[133] AT&T conveniently ignores the fact that an X-factor had been in effect for seven years prior to that, apparently without bringing the industry to its knees. Moreover, as the Commission well

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[129] ATX *et al.* Comments at 44-45; Joint CLECs 7/29/05 Comments at 45-46.

[130] AT&T Comments at 40.

[131] Ad Hoc 7/29/05 Comments, Declaration of Susan Gately, ¶ 8 & ¶ 10.

[132] Sprint Comments, Declaration of Bridget Mitchell, Exhibit 2.

[133] AT&T Comments at 42 & n.86 (citing *United States Telecom Ass'n v. FCC*, 188 F.3d 521 (D.C. Cir. 1999)).

knows, the D.C. Circuit did not condemn the concept of an X-factor, nor the formula by which it was calculated. Rather, it criticized the Commission's lack of explanation for the process by which it selected the data to enter into the formula.[134] This by no means amounts to an indictment of the X-factor concept, nor do any of these criticisms portray a fatal problem. The Commission established legally sustainable X-factors in the past and can do so again.

Consistent with the Commission's justification of the X-factor in the *LEC Price Cap Order*, the Commission should re-impose a productivity X-factor offset in the price cap formula to ensure that rates continue to decline relative to the measure of inflation, GNP-PI.[135] Although the Commission should, at a minimum, apply the X-factor prospectively, it should also apply it retroactively back to 2004,[136] when the Commission, under the CALLS Plan, effectively eliminated the X-factor and froze the Price Cap Index ("PCI").

D. Other Reforms Proposed By the Joint CLECs Should be Adopted

As proposed in earlier comments, along with reinitializing rates and re-imposing the X-factor, the Commission should also reinstitute sharing.[137] If the marketplace were as competitive

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[134] Specifically, the court determined that the Commission should have explained (1) why outlying historical productivity data was unreliable or its use inappropriate, (2) how it determined that there was an upward trend in the historical data, and (3) why it accepted estimates of the range of reasonableness based on methodologies that it had previously discredited. *United States Telecom Ass'n v. FCC*, 188 F.3d at 525-526.

[135] *LEC Price Cap Order*, ¶ 75

[136] Since substantial evidence demonstrates that special access rates are unreasonable, such retroactive true-ups would be permissible. *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384, 387-89 (1932) (A carrier charging a merely legal rate (in that it was properly filed) may be subject to refund liability if customers can later show that the rate was unreasonable. Should an agency declare a rate to be lawful, however, refunds are thereafter impermissible as a form of retroactive ratemaking).

[137] ATX *et al.* Comments at 45-46; Joint CLECs 7/29/05 Comments at 48-50.

as the BOCs claim, they would never earn such windfall profits. In addition, the Commission should not only establish separate baskets for DS1, DS3, OCn, mass market broadband and DSL, and retail special access but also establish specific categories for the DS1 and DS3 services.[138] This will prevent BOCs from offsetting rate reductions where there is competition with rate hikes between and among the various categories where there is none, such as the BOCs offsetting reduced prices for competitive residential high speed services by charging exorbitant monopolistic rates for functionally equivalent special access services.[139] The Commission should concurrently abolish Phase II pricing flexibility altogether.[140]

VIII. THE COMMISSION SHOULD REJECT BOC REQUESTS TO RELAX REGULATORY OVERSIGHT OF SPECIAL ACCESS

The BOCs request a variety of modifications to price cap and pricing flexibility rules that would exacerbate the already bad situation the Commission's rules have permitted BOCs to create. AT&T, Qwest, and Verizon request that the Commission grant Phase I pricing flexibility everywhere.[141] AT&T and Qwest request that the Commission deregulate all OCn level and packet-switched services. The BOCs also urge the Commission to grant pricing flexibility even where fiber-based triggers are not met based on other showings of competition, such as the presence of competitive fiber, or "evidence" of intermodal competitors being used for high capacity services, including self-supply.[142] Verizon additionally requests that the Commission

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[138] ATX *et al.* Comments at 47-49; Joint CLECs 7/29/05 Comments at 50-52.

[139] *See* Ad Hoc Comments, ETI-Special Access Overpricing and the US Economy, Appendix 1 at A-5 through A-10.

[140] ATX *et al.* Comments at 49-51; Joint CLECs 6/13/05 Comments at 32.

[141] AT&T Comments at 26-28; Qwest Comments at 61-62; Verizon Comments at 45.

[142] Verizon Comments at 48-50.

eliminate restrictions on growth discounts,[143] and that the Commission eliminate the requirement that BOCs show that banded mileage pricing is not unreasonably discriminatory.[144]

All of these requests should be rejected because they are premised on the faulty view that the special access market is sufficiently competitive to permit reliance on competitive forces, rather than regulation, to assure reasonable prices, terms, and conditions. As shown in initial comments and as found by every regulatory authority that has looked at the matter, including the Commission, DOJ, and even GAO, BOCs control last mile access to the vast majority of customer locations.[145] Therefore, there is no basis for relaxing the Commission's already too deregulatory program of special access oversight.

Apart from relying on a generally false premise, the BOCs proposals are flawed in other respects as well. The requests for the sweeping relief of universal Phase I pricing flexibility and deregulation of all OCn and packet-switched services ignore the fact that, even if there is competition at some building locations, most are not subject to competitive supply. In non-competitive areas, BOCs could engage in anticompetitive below cost pricing and cost shifting implemented via contract tariffs to deter competitive entry. BOCs could overcharge for OCn and packet switched services in markets where there is little threat of competition.

The BOCs' proposals that the Commission rely on the presence of competitive fiber to grant pricing flexibility is flawed because the presence of competitive fiber somewhere in an MSA does not relate to any practical ability to serve customers to any or all other portions of the MSA. Distance from customers, inability to access ILEC conduit, building access issues, and

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[143] Verizon Comments at 46-48.

[144] *Id*. at 50.

[145] ATX *et al* Comments at 23-25.

lack of significant high capacity demand at a location, among other reasons, precludes competitors from reaching most customer locations in an MSA notwithstanding the presence of some competitive fiber.[146] BOCs have also failed to present any workable proposal for relying on competitive fiber. Their vague, undetailed maps of MSAs are in no way probative of competitors' ability to serve customers over their own last mile connections anywhere in the MSA. BOCs' proposed reliance on "evidence" of intermodal facilities is also completely unworkable and non-probative of competition that could constrain prices for the same reasons as with respect to competitive fiber and for the additional reason that self-supply does not constitute competition that can significantly constrain BOC prices.

Verizon's request that the Commission permit banded mileage pricing without an obligation to show that this would be implemented in a nondiscriminatory fashion should be rejected out of hand. Mileage bands provide ample opportunity for BOCs to implement unreasonably discriminatory and predatory pricing programs by fashioning bands that shift costs to bands that are less likely to be competitively supplied and raising prices in others. The Commission should retain the requirement that BOCs fully justify any proposed mileage pricing bands.

Verizon's request to eliminate limitations on growth discounts should also be rejected. A customer's prior purchase history has absolutely no relationship to efficiencies that BOCs could achieve for current purchases. Discounts based on percentage gains or increases over previous purchase levels are offered for the sole reason of assuring that a customer's growth needs are not met by competitive providers. Growth discounts are anticompetitive attempts to lock-up

[146] *TRRO*, ¶¶ 149-154.

customers and inhibit facilities-based competition. While BOCs may fashion discounts based on the level of a current purchase volume, the Commission should continue to prohibit growth discounts.

Accordingly, the Commission should reject all BOC proposals to relax rules governing special access and, for all the reasons stated in earlier comments, the Commission should abolish Phase II pricing flexibility and establish a number of refinements to price cap regulation that will better assure that BOCs establish reasonable prices and other terms and conditions for interstate special access service.[147]

[147] ATX *et al.* Comments at 39.

IX. CONCLUSION

For the foregoing reasons, the Commission should promptly establish the price cap and pricing flexibility reforms requested herein.

Respectfully submitted,

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